



Governor's Office *of*  
Economic Development

BUSINESS • TOURISM • FILM

# Understanding the Challenges of Doing Business In China

China promises  
good fortune

Beware of China.  
Danger ahead

In China...

Everything is possible, nothing is easy.

~ **MacDonald's theorem**



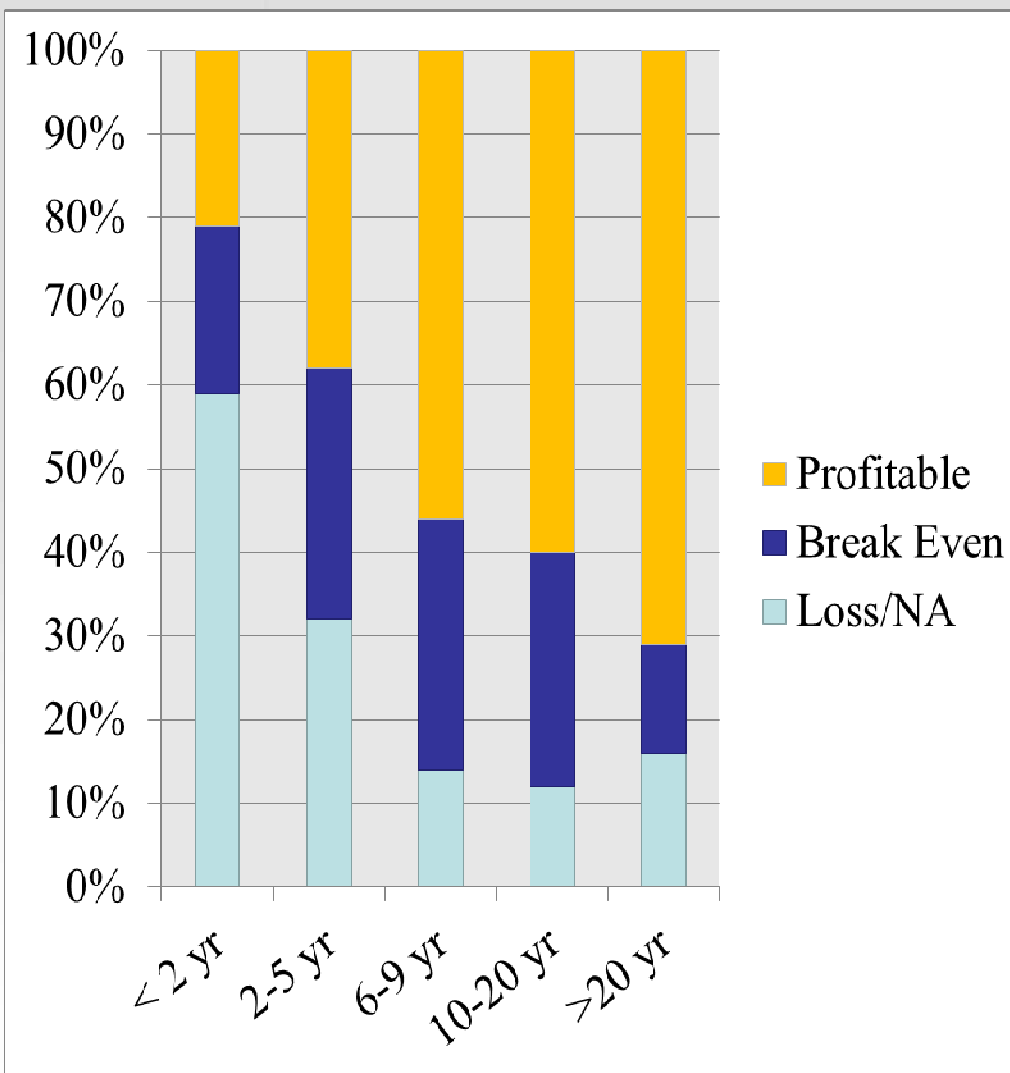
China promises  
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# China rewards the persistent

## U.S. Company Profitability (By years in the market):

- <2 yrs: 21%
- 2-5 yrs: 38%
- 6-9 yrs: 56%
- 10-20 yrs: 60%
- 20+ yrs: 71%



# Today's Headline News...

- **Fastest growing export market for the US**
- **U.S. exports to China \$91.8 B in 2010, up 32%**
- **China trade surplus fell \$102 B; FX reserves =\$2.4 T**
- **Per capita GDP up to approximately \$ 4,382 (nominal)**
- **China's goal is to quadruple GDP in 20 years, which implies an average 7.3% annual growth.**



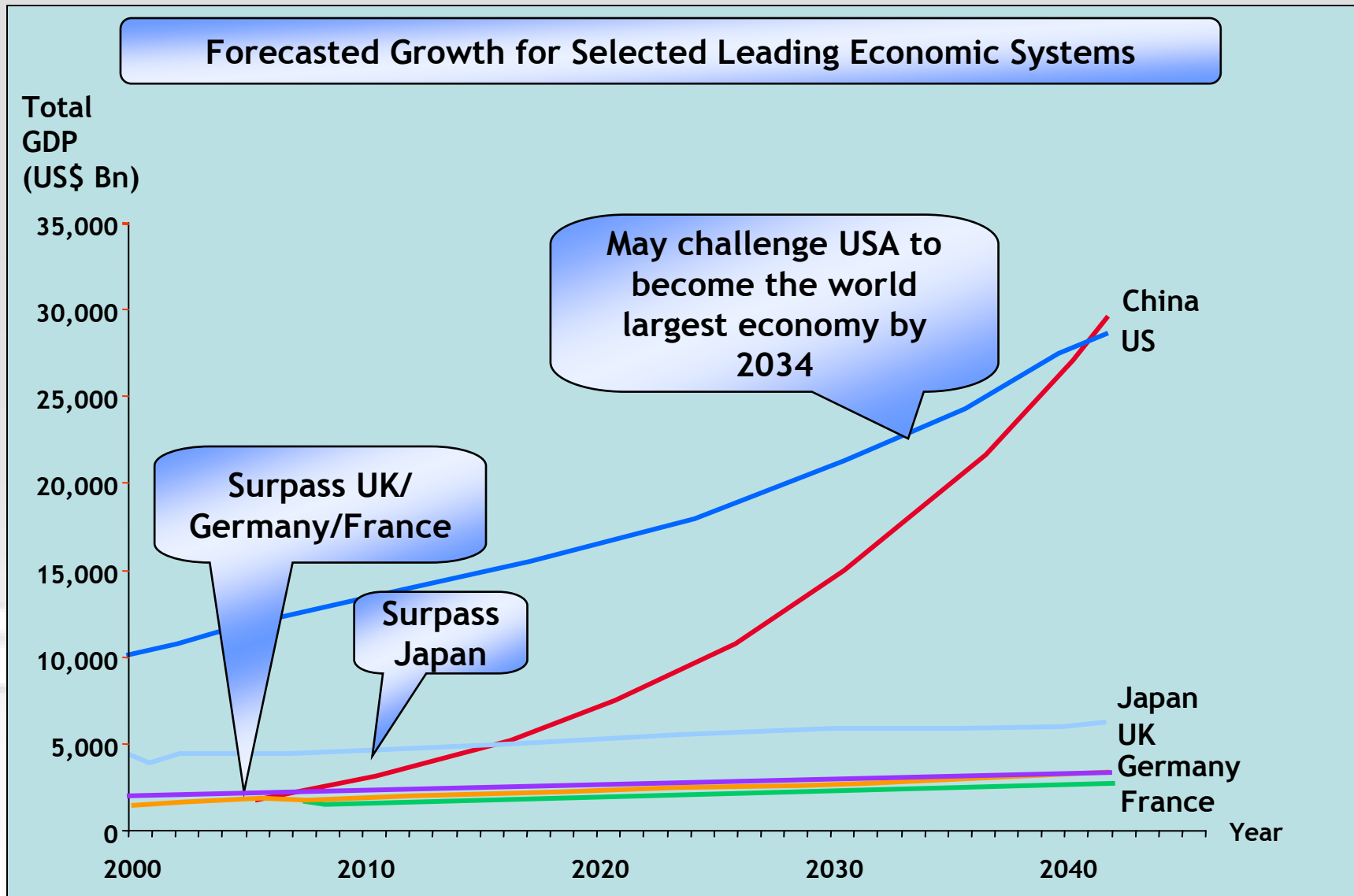
# A Historical Look...

- **China has been the world's largest manufacturer for at least 3,000 of last 4,000 years.**
- **In 1820, China represented 36% of world GDP, vs. 32% for USA. In 2006, China 15% vs. U.S. 20%**
- **Historic tide shifted in 1842 with Opium War, colonialism, disintegration, WW2 and Communism.**
- **In 1979, Deng Xiaoping introduced economic reforms and opening to the outside world. Confirmed in 1992.**
- **Initiated a 32 year process of 6–14% annual GDP growth. Average 9% growth.**



2034?

China will become the largest economy by ~~2040~~



Source: Goldman Sachs Research Report



# The China Dream has Massive Implications...

- **China's global consumption:**
  - **Cement: 50%**
  - **Iron Ore: 43%**
  - **Coal: 40%**
  - **Steel 33%**
  - **Oil: second largest**
  - **Vehicles: largest market (\$110 billion in sales)**
  - **Mobile on line service users: 233 million**



Source: Dept of Commerce, US Foreign Commercial Service

# A More Realistic Picture...

## **Pollution**

- **70% Electricity from coal**
- **#1 Emitter of fossil fuels**

## **Unemployment**

- **Official 4.3%**
- **Unofficial 9%**



Source: Dept of Commerce, US Foreign Commercial Service



## *The AMCHAM Shanghai China Business Report 2010-2011*

### Quick look at profitability

- 87% of U.S. Companies in China report revenue growth, 47% in 2009, 77% 2008
- 79% say are in the black, 65% 2009, 70% 2008
- 61% gained market share for China products and services, 40% 2009, 52% 2008



# *The AMCHAM Shanghai China Business Report 2010-2011*

**Successful**

**Confident**

**Welcoming**



## *The AMCHAM Shanghai China Business Report 2010-2011*

### **Who is the most successful, welcomed, and confident?**

- Revenue over \$10 million
- Have over 10 percent of the market share
- Been in China for more than 10 years



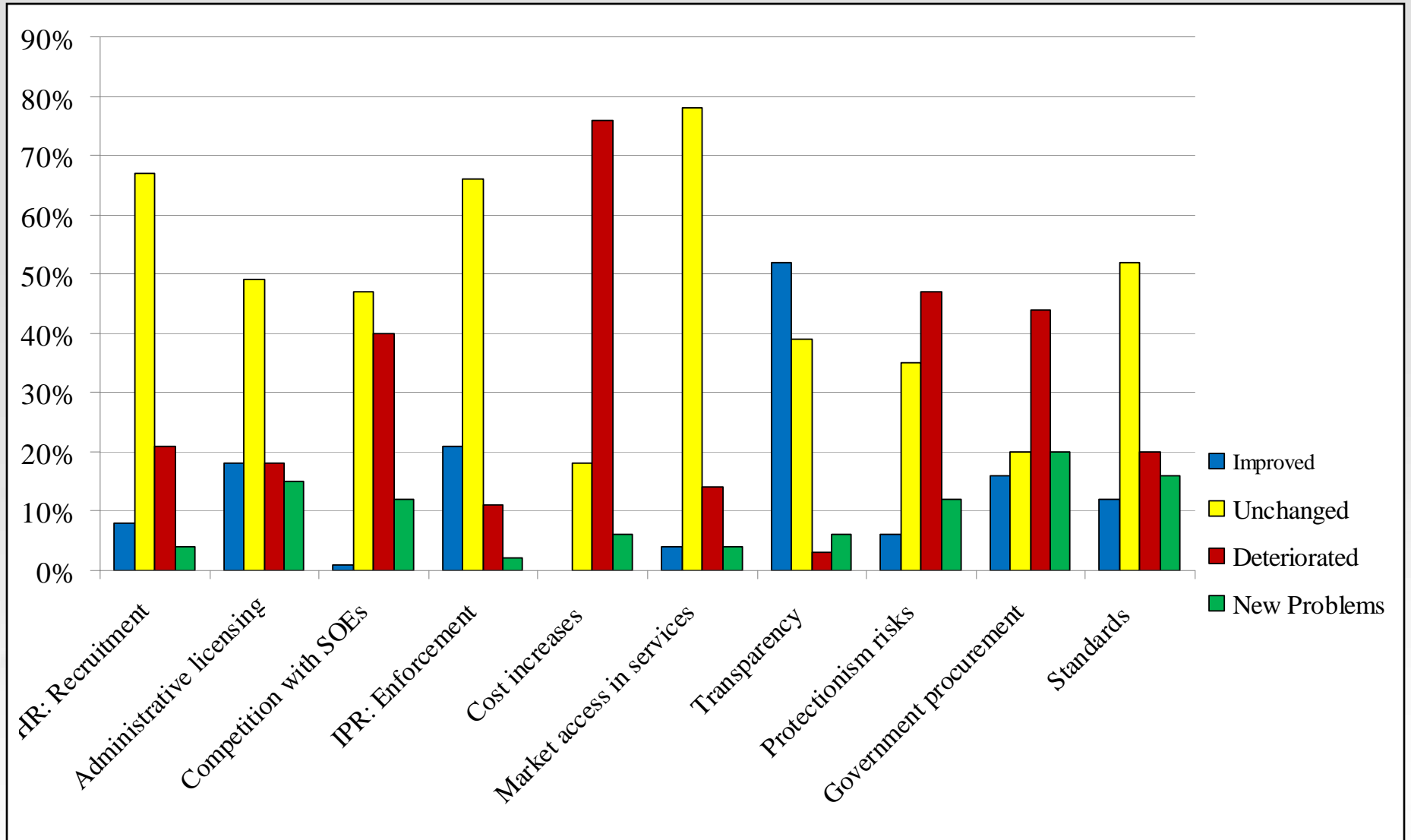
## **Top 10 Challenges**

- 1. HR constraints**
- 2. Inconsistent regulatory interpretation**
- 3. Unclear regulations**
- 4. Bureaucracy**
- 5. Lack of transparency**
- 6. IPR infringements**
- 7. Tax administration**
- 8. Domestic Protectionism**
- 9. Difficulty enforcing contract terms**
- 10. Corruption**



Source: Shanghai AMCHAM 2010-2011 Business Report

# Progress on Top 10 Issues



# Today's: Focus the Top Three Problems

## **1. HR constraints**

## **2. Regulatory problems**

- **Inconsistent Interpretation**
- **Unclear regulation**
- **Bureaucracy**
- **Lack of Transparency**

## **3. IPR Infringement**



# HR Constraints

## Solutions

1. Providing more compensation and benefits
2. Building a stronger corporate culture
3. Providing more opportunities for advancement
4. Providing more *soft skills* training (i.e., communication, leadership, teamwork, etc)
5. Putting a better candidate screening process in place
6. Improving performance evaluation system
7. Providing more technical training
8. Looking outside major cities for good candidates



# More HR Strategies

1. **Outsource Staffing Services (FESCO)**
2. **Selecting your hiring pools**
  - Local Hires
  - Returnees
  - Expats
  - Asia Expats
3. **Incentives**
  - Advancement
  - Training
  - Benefits
  - Job Titles





# Outsourcing Staffing Services

## **Pros:**

- **Expert help**
- **Less Hassel**

## **Cons:**

- **Costly**
- **Often have to pay employees extra bonuses**



# Selecting Your Hiring Pools

**Local Hires-** Least expensive; have knowledge about Chinese market; May require training in western business practices

**Returnees-** Have a good understanding of western practices; often require higher wages; sometimes don't completely understand China's Market

**Expats-** Most expensive, often face language and cultural barriers

**Asia Expats (Hong Kong Taiwan, Singapore) -** Less expensive than western Expats; generally have a better understanding of Chinese language and Culture



# Management: Demand exceeds supply for experienced managers

- Few over ~40 have experience managing in a market economy
  - market economy since late 1980s
  - “lost generation”
- Foreign companies need managers with English ...
- ... and believe they need managers with a “Western mentality”
- All look for same profile: “5-10 years relevant experience, overseas MBA, MNC work experience”

**Obvious  
result:**

**Spiraling salaries & low retention**

**Subtle  
result:**

**Risk getting isolated  
from the real market**



# Incentives

- **Advancement**
- **Training**
- **Benefits**
- **Job Titles**



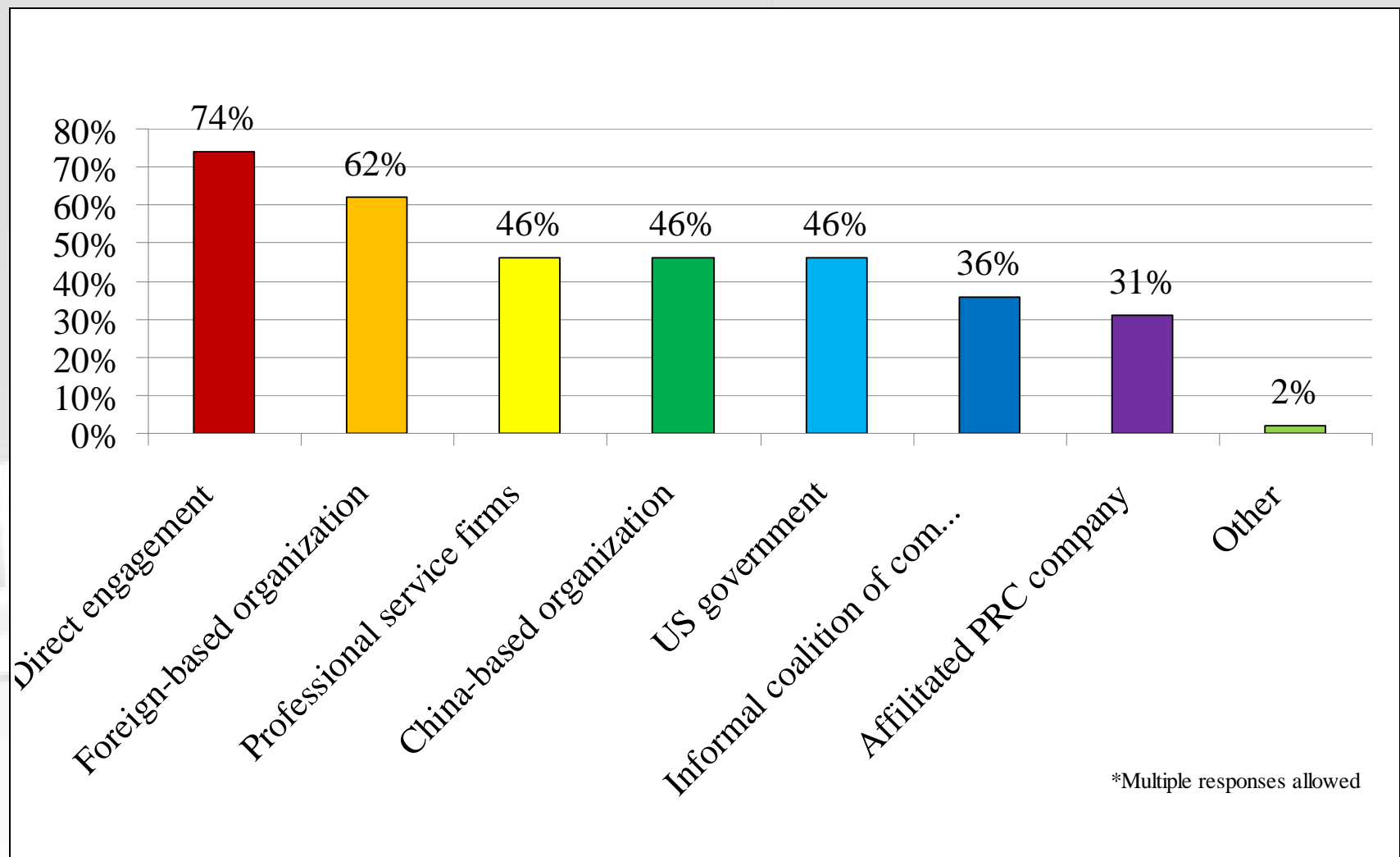
# Regulatory problems

## Solutions

1. Visit China
2. Network
3. Obtain Expert Advice  
(Attorney/ Consultant)
4. Get a good partner
5. Guanxi



# Advocacy Channels or Strategies Pursued\*



# **IPR Infringement**

## **Solutions**

- 1. Obtain rights in a timely manor**
- 2. Split production**
- 3. Business structure**
- 4. Computer protection**
- 5. Legal representation**
- 6. Enforcement**
  - Administrative**
  - Criminal**



# “Same Bed, Different Dreams”

## Joint Ventures:

Issue	Your Partner Wants	You Want
Capital Injection	Maximize Cash	Minimize Risk
Technology	Latest	Appropriate
R&D	Max, independent	Min., control
Localization	Max, in-house	Supply from self
Export	Maximize	No, competes w/self
Domestic Sales	Balance, Control	Maximize, Control
Brands	Develop Own	Develop Own
Control	Maintain Control	Get & Keep control



Source: ATKearney, Beijing



# “Same Bed, Different Dreams”

## Joint Ventures:

*think you*

Why do you <sup>think you</sup> need a partner?

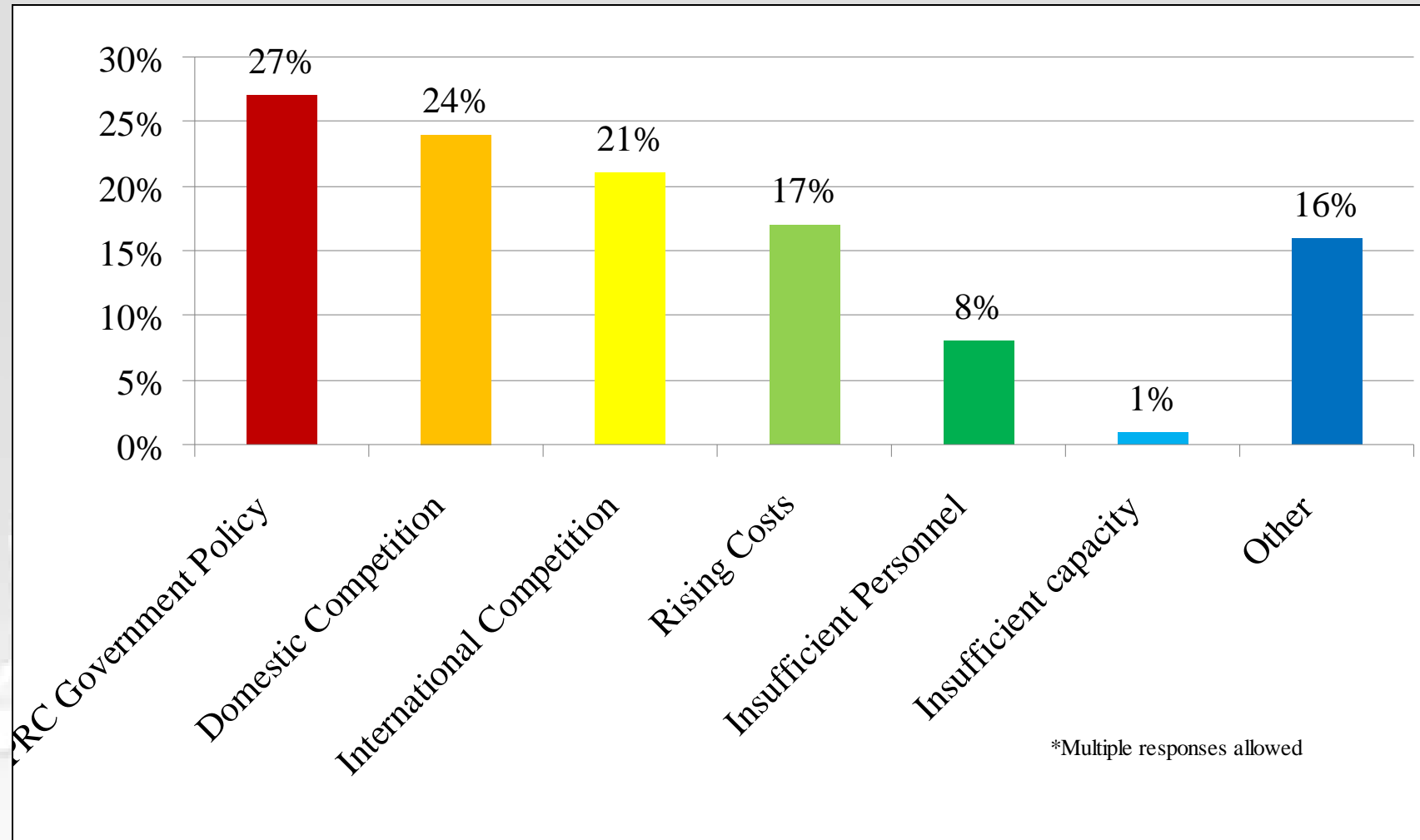
- China's Industrial policy requires you to have one → OK, do it (autos, banks, ...)
- Need access (e.g., sites for retail) → OK ... (but you may not want to know the details)
- Don't understand the market → No, hire good managers instead

Rules to minimize partner conflicts:

- Don't partner with someone in your own business ... look for complementarity (GE)
  - Access to retail sites
  - Access to 'protective cover'
  - Existing distribution channels (but ... competitive conflict?)
- Minimize the different ways the partners have to make money ... ideally, from JV earnings alone. (VW's problems)
  - Avoid partner controlling key raw material, or who is the only customer.
- Avoid 50/50 deals – nobody's in charge
- Don't believe you are dealing with “the government” -- you aren't; it's a company
  - And don't believe that support from “the government” will help much beyond the specific scope of the agency's authority – if at all.
- Pay attention to local politics – Beijing can't/won't help much if the local's are against you (Armand Hammer – Pingshuo Coal)



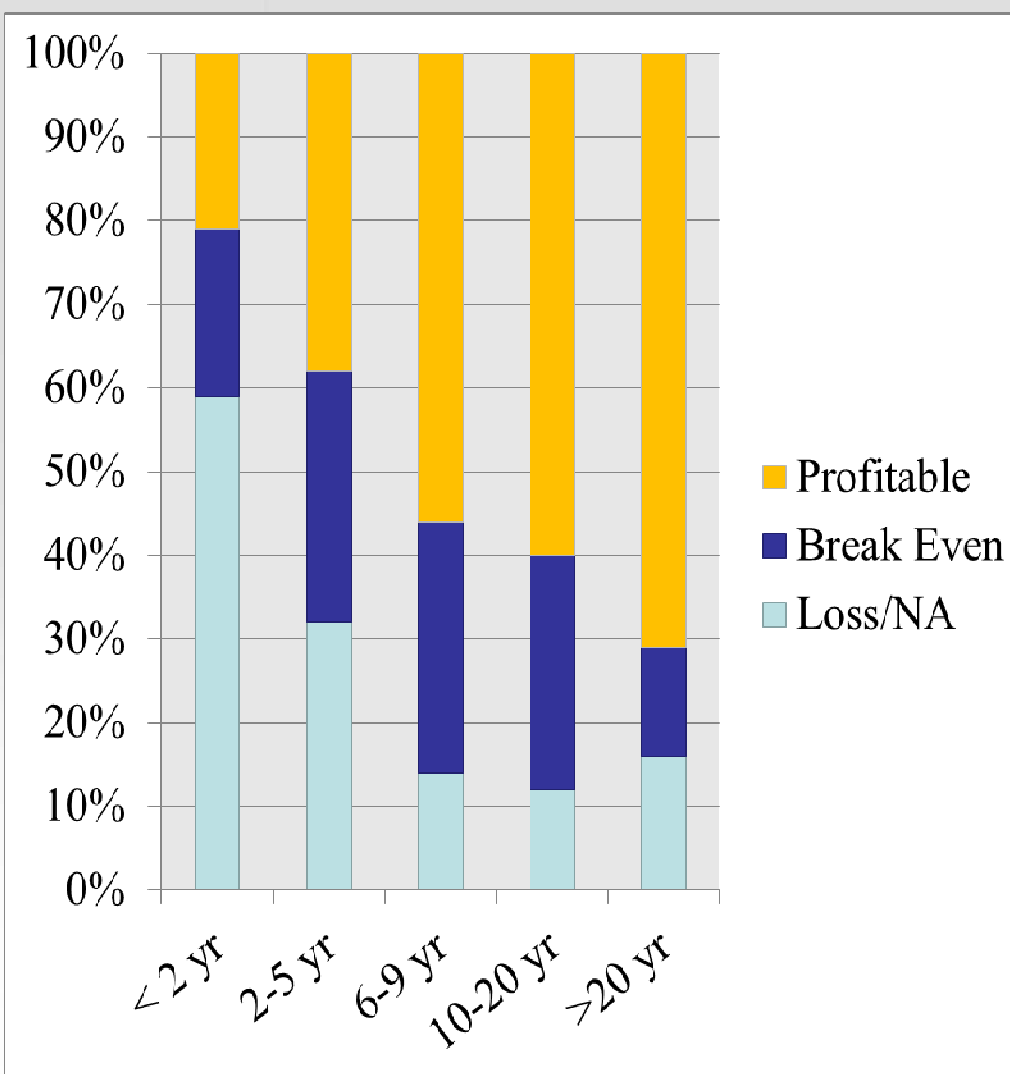
## Primary Restraint on Increased Profitability in China\*



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# Thank You

